Progressive approach towards organizing the Indian Gold Industry-A Perspective

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Gold acts as an international reserve asset that serves as a hedge against Economic/ Geo-Political Turmoil /Inflation as well as a Quasi-Currency. Gold is held by central banks around the world in proportion to their foreign exchange reserves in order to stabilize their national currencies. As a precious metal, gold serves as portfolio diversifier and an important asset class like equity, fixed income, currency, and real estate.

In recent times, central banks demand for gold returned after the global macro-economic turbulence that presaged the COVID-19 pandemic and peaked in 2022–2023. The central banks signalled their shift towards gold as a reserve asset because of geopolitical instability, ambiguous monetary policy orientation across nations, increased sovereign risk, and inflation reaching a 40-year high (particularly in the US).

Gold Infrastructure and Policy Landscape

With India being one of the largest consumers of gold, the Government has taken constructive steps for helping develop the bullion and jewellery industry into an organized sector.

A perspective on certain key policy issues and recent steps, which have an impact on this industry is given below.

1. Gold - Custom Duty Tariff

Given that India is one of the biggest gold importers, the customs levy has a significant impact on the sector. The Custom Duty has been hiked to 10% from 2% through repeated increases between January 2012 and August 2013. The Total Import tariff on the gold bar and gold Doré are 15% and 14.35%, respectively. It constitutes the Agriculture Infrastructure Development Cess (AIDC) and the Basic Customs Duty (BCD). With the additional 3% Integrated Goods and Services Tax (IGST), the end consumer effectively pays 18.45% tax for refined Gold. Although the sector had anticipated a decrease in the import duties, the same has not materialized in the union budget of 2023.

2. Prevention of Money Laundering Act (PMLA)

The guidelines on Anti-Money Laundering (AML) Standards and Combating the Financing of Terrorism (CFT) – obligations for dealers of precious metals and stones under the Prevention of Money Laundering Act 2022 were notified in February 2023. That this happened in the run up to the Financial Action Task Force (FATF) Mutual Evaluation (M.E.) of India, scheduled in 2024, is commendable in every way.

3. Mandatory Hallmarking of Gold Jewellery

A new regime in the history of Gold commences in this financial year. The Ministry of Consumer Affairs, Food & Public Distribution has notified that the sale of hallmarked gold jewellery or gold artefacts without a 6-digit alphanumeric HUID shall not be permitted to be sold after March 31, 2023. It is expected to safeguard and protect the consumers' interests and enhance their confidence in purchasing hallmarked gold jewellery with traceability and quality assurance. It begins a new chapter in the Indian Gold story.

The government announced implementation of hallmarking in 256 districts (out of 742). Under the new BIS guidelines, mandatory hallmarking is applicable to six purities: 14k, 18k, 20k, 22k, 23k and 24k. It is stipulated that any jeweller in these districts with turnover of more than Rs. 4 million must register with BIS to sell hallmarked jewellery. According to numbers released by the Goods and Services Tax (GST) Council, around 86,000 jewellers have registered for taxation purposes.

4. Alternative Modes for Investment / Mobilization of Gold

Whether it is the Sovereign Gold Bond (SGB), Digital Gold, Gold Exchange Traded Funds (ETFs) or Gold Mutual Funds - all gained traction amongst the Indian public in the previous financial year, which is particularly commendable in a nation obsessed with physical Gold.

a. Sovereign Gold Bond Scheme (launched November 2015)

Reserve Bank of India launched Sovereign Gold Bonds (SGB) in November 2015 as an alternative to physical gold. In 2022-23, RBI issued four series of SGBs that were open for subscription. The aggregate total outstanding of SGB as of 14th March 2022 was approx. 101.5 tonnes. FY2022-2023 saw addition of only 12 tons.

Data on Sovereign Gold Bonds (Tranche wise) as of March 2023:

Year	Average issue price/unit	Number of units subscribed (in kgs)
2015-16	2684	913.57
2016-17	2955	15377.48
2017-18	2932	6524.69
2018-19	3183	2030.87
2019-20	3779	6131.17
2020-21	4926	32351.96
2021-22	4828	27035.14
2022-23	5327	12260.87

Considering that the SGB Scheme offers a yield of 2.5% and assures capital gain accrual to buyer, it is an innovation in the right direction, that may reduce physical import dependence as we move along. Such schemes capture the imagination of young working professional segment more easily.

b. Gold Monetisation Scheme (GMS)

Gold Deposit Scheme of 1999 was withdrawn and relaunched in new form as GMS (November 2015).

The GMS is an initiative to mobilise the gold held by households/ institutions, to put it into productive use and to cut current account deficit by reducing import dependence. The program provides the depositors an interest at 2.25% per year on short-term deposits and 2.5% for medium and long-term deposits. The total gold mobilized via GMS is approximately 20 tons and mostly from temple trusts. The scheme is yet to see proven success as people are hesitant to surrender legacy jewellery and to disclose quantum held by them.

5. India-UAE Comprehensive Economic Partnership Agreement (CEPA)

Presently, as per the provisions of the India - UAE (CEPA), Gold can be imported by the Tariff Restricted Quota (TRQ) license holders, either through nominated banks/ or if TRQ holders are also Qualified Jewellers, then through India International Bullion Exchange (IIBX). Imports at concessional duty to aide jewellery manufacturing, is a welcome step. Also, this benefits from traceability and transparency of trade via IIBX, which is being developed as gateway of gold import.

6. Directions from the Reserve Bank of India (RBI) regarding Hedging of Commodity Price Risk and Freight Risk in Overseas Markets - 2018

The RBI Circular dated March 12, 2018 – “Hedging of Commodity Price Risk and Freight Risk in Overseas Markets (Reserve Bank) Directions” removed gold from the list of commodities whose price risk could be managed overseas. The gold jewellers and refiners who were availing this facility are now hedging price risk on domestic exchanges like MCX. The open interest being absorbed easily in domestic benchmark contracts speaks of healthy liquidity in exchange eco-system.

7. An evolved Commodity Exchange Framework (MCX)

MCX, India’s leading commodity Exchange, with nearly 99.9% share of the bullion derivatives market plays an important role in serving risk management needs of the bullion & jewellery value-chain as well as the investment/trading community at large. MCX has extensive national reach, with 548 registered members and 50,228 authorized persons with its presence in around 700 cities and towns across India as on 31 March 2023.

MCX bullion prices are the benchmark for value-chain and end-consumers alike. Further, MCX Gold prices reflect all four elements: USD/INR exchange rate, Custom Duty tariff, International prices along with the Domestic premium/discount. This close integration of the MCX futures and gold spot markets in India, ensures an efficient platform for price risk management. MCX has seen deliveries of 135 MT of Gold since inception.

In line with the broader national objective of ‘Atmanirbhar Bharat’, MCX empanelled domestic refiners as per “MCX Good Delivery Norms for BIS-Standard Gold/Silver” effective from March 6, 2021 and has seen a **successful delivery of 5633 kg valued at Rs. 2988 crore till June 2023**. This will serve the nation by reducing disparities, encouraging recycling and reducing import dependence.

8. India International Bullion Exchange (IIBX) at IFSC GIFT City

The launch of IIBX at GIFT-IFSC is a significant reform in the Indian bullion market at par with the significant step of liberalizing gold imports in 1997. The exchange has been set-up to create integration of India’s gold trading with the international markets and position it as major trading and vaulting centre globally. IIBX will bring standardization of gold imports under robust regulatory environment for trade. It is expected to reduce market disparities by creating transparency and traceability.

The exchange aims to disintermediate the import process via its contracts where qualified jewellers and suppliers can trade directly through a regulated platform, making bullion available across the SEZs at the IFSCA approved vaults. The customs ICEGATE platform integration has finally taken shape only in May 2023, which means that concessional imports under UAE-CEPA via IIBX, that were delayed will drive volumes now.

Over the coming years, IIBX is expected to become the gateway for gold imports into India.

Signs of Coming Times and the Way Forward

It has been thirteen years since central banks started acting as net buyers in 2010–2011. In 2022–2023, Reserve Bank of India continued to buy gold, increasing its stockpile by 8.7% to 794 tons. This highlights the prudence of holding gold as an asset amid uncertain times. Therefore, India’s gold policy for 2023–24 will need to move away from the existing focus on taxation, custom levies, free trade agreements alone and instead realign the vision on how to use gold as a pillar for our economy as was traditionally.

Emergence of De-dollarization- A key driver for Gold Policy

The new trend of de-dollarization impacts gold policy in the future. The dollar as reserve currency is losing its sheen. De-dollarization lets countries have control on their economic policies and reduces vulnerability to external economic shocks. This will increase bilateral trades in other currencies and promote assets including gold thereby reshaping the international monetary system.

De-dollarisation may increase currency risk and macroeconomic uncertainty, prompting investors and central banks alike, to seek safe-havens like gold. Gold in the process of de-dollarization ensures market stability and liquidity, also shielding currencies against inflation and loss of value.

Few recent signs of de-dollarization:

- Central banks added over 1100 tons of Gold to their reserves in 2022, about a quarter of the annual production of Gold.
- India is promoting its own digital payment system, UPI, to reduce USD usage. India has signed an MOU with over 10 countries including Singapore, to utilise the UPI interface.
- Russia started trading in Yuan to reduce exposure to USD and Euro.
- USD reserves held by central banks have declined from 71% in 1999 to about 59%, the lowest since the mid-1990s.
- The U.S.'s share of global GDP has declined from 31.4% in 1970 to 23.25% currently, with China's share of global GDP at 17%. If the U.S.'s share remains poor for longer time-period, it is difficult for USD to maintain its reserve currency status.

Hence, there is an urgent need to promote Gold as investment avenue for citizens via enabling products and infrastructure. There is also cause for central banks to hold gold as a larger percentage of their forex reserves.

Factors that need addressal for enabling the Gold Asset Class

Some of the important areas to look at for enabling gold as an asset class are given below.

1. **Enabling GST off-set to depositor of Electronic Gold Receipts (EGR)**

   Government of India vide Gazette notification S.O. 5401 (E) dated December 24, 2021, has declared "electronic gold receipts" as 'securities' under the Securities Contracts (Regulation) Act 1956("SCRA"), paving way for operationalizing of Gold Exchange or EGR segment. This brings to the fore a spot gold product under Regulatory aegis of SEBI that has two-layer Regulatory protection- trade on exchanges and electronic holding with depository. This paves way for Mutual funds, ETFs and investors at large to invest in Gold dematerialized like shares and accumulated till re-materialisation into physical gold. However, a crucial GST related issue needs addressal to make EGR successful. The process is that a depositor who has paid 3% GST would deposit gold with the vault for conversion to EGR. The EGR would be traded on Exchange without GST and would change multiple hands before someone opts to rematerialize and take physical delivery out of vault. However, the initial depositor would not get GST refund till EGR is rematerialized for physical gold. This blocks the initial depositors' capital of 3% by value of gold, which is significant, rendering the product a non-starter.

   The following solutions are proposed to the Government:

   a) Transactions in electronic receipts pursuant to exchange trade be exempt from GST. The depositor may be allowed to avail credit of GST paid. IGST may be applied only on conversion of electronic receipt into physical goods.

   b) An alternate in case point no. a) is not acceded to, is that the Dealer Entity (DE) (maybe Exchange Clearing Corporation) be allowed to act as agent to Financial Investors for raising invoices.

   A solution must emerge in a way that EGR meets its true potential as the real way to hold gold asset for the masses.

2. **Cut in import duty of Gold is needed to reduce smuggling**

   Policymakers have adopted the practice of levying a greater charge on imports to address the current account deficit while being aware of the potential incentive that higher duty offers to global smuggling ecosystems. In the DRI report on smuggling, India indicates a 63% increase in number of seizure gold cases from 2021 to 2022. The higher taxes do lead to a higher propensity for smuggling. This is evidenced as a probable increase in unofficial imports in second half of 2022-23, following a rise in customs duty, reduced official imports to only 285 tons. Any tariff more than 4-5% makes smuggling viable as cost is then less than higher return available. In fact, such levels of smuggling cannot be positive for the Current Account Deficit (CAD).

   FATF Mutual evaluation of India

   There is an urgent need to stop the increase of gold smuggling into India because the FATF's mutual evaluation of India, which is a detailed country report analysing the implementation of measures to combat money laundering and terrorist financing, is coming up in 2024. It may be noted that the Customs Act violations in India are scheduled offences under the Prevention of Money Laundering (unlike other tax offences like GST & Income Tax), which puts more emphasis on this problem. Gold Smuggling is a classic example of breaking all laws in the context of an economic crime because the well-organized Hawala network also violates the Foreign Exchange Management Act (FEMA).

3. **CTT and its impact on Hedging Efficiency**

   CTT, or Commodity Transaction Tax, is a tax imposed on transactions. Being a value-linked tax (at Rs.1000/ crore on sell side), it has large impact in high-value commodities like gold exchange traded derivatives.

   CTT has increased the transaction costs for not only trading but also hedging. This has reduced the effectiveness of hedging strategies, affecting bid-ask spread, adversely impacting order book health. The impact cost of hedging has increased with lesser depth available at single price. With higher bid-ask, the presence of jobbers has been marginalized in bullion contracts. Jobbers are in fact liquidity providers who populate order books at every tick thereby making the entry / exit for hedgers smooth. A higher bid-ask in Gold impaired not only price discovery and market efficiency, but also denied socio-economic benefits to jobber community.

   Due to imposition of CTT, market participants are inclined to explore alternative unorganized hedging instruments that are not subject to the tax like the dabba trading.

   Hence, it is strongly recommended that CTT be rationalised.

In Conclusion

It is well-known that Gold has been integral to the socio-economic fabric of India from generations. Indian households are said to possess about 25000 MT of Gold as domestic holding. However, thus far policy around Gold has attempted to enable this as a mobilized economic asset but not with much success. We need to seriously review the duties/levies that are inhibiting the growth of this sector into a more organized and above the board business. It is expected that spot products under regulatory aegis that are likely to do well, need to be encouraged even at the cost of giving specific relief from GST. While the policy aims to make the consumer- end strictly above board on one side, the same is rendered difficult by the prevailing high duty / tax structure which encourages smuggling. It is hoped that a comprehensive perspective would pave way for an inclusive and effective Gold Policy for the nation.